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# REPORT TO THE CONGRESS



## Audit Of The Rural Telephone Bank For Fiscal Year Ended June 30, 1973

B-159292

Department of Agriculture

**BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES**

APR 10 1974

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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-159292

To the President of the Senate and the  
Speaker of the House of Representatives

This is our report on the audit of the Rural Telephone Bank, Department of Agriculture, for the fiscal year ended June 30, 1973. 271

We made the audit pursuant to the Government Corporation Control Act (31 U.S.C. 841).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretaries of Agriculture and the Treasury; and the Governor, Rural Telephone Bank.

A handwritten signature in cursive script that reads "James B. Stacks".

Comptroller General  
of the United States

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D I G E S T

WHY THE AUDIT WAS MADE

GAO is required by law to audit annually the Rural Telephone Bank, a Government corporation established to help meet the growing capital needs of rural telephone systems, and report to the Congress.

OPINION ON FINANCIAL STATEMENTS

In GAO's opinion the Bank's financial statements present fairly its financial position at June 30, 1973, and the results of its operations and the changes in its financial position for the year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States. (See p. 16.)

OTHER MATTERS OF INTEREST

The Bank is supervised and directed by the Secretary of Agriculture. The Administrator of Agriculture's Rural Electrification Administration (REA) serves as Governor of the Bank, the Bank's chief executive officer. Since 1949 REA has been authorized to make loans for furnishing and improving rural telephone service.

The Bank's general purposes are to:

--Obtain an adequate supply of funds, from the sale of stock and debentures, to supplement REA's telephone loan program.

--Use its funds to make loans to providers of telephone service in rural areas which have received REA loans or loan commitments or which have been certified by the Administrator to be eligible for them.

--Conduct its operations, to the extent practicable, on a self-sustaining basis. The Congress objective is that the Bank eventually become an entirely privately owned, operated, and financed corporation. (See p. 3.)

Through June 30, 1973, the Bank made loan commitments of about \$241 million to 214 borrowers. This was an increase of about \$150 million for loan commitments and an increase of 125 borrowers since its initial 9-month period of operations which ended June 30, 1972. (See pp. 11 and 12.)

Advances totaling about \$46 million were made to 93 borrowers. This was an increase of about \$45 million in advances and an increase of 91 borrowers. (See p. 11.)

The rural telephone program for REA and the Bank combined added 20,155 miles of telephone lines and 156,193 additional subscribers during the year. (See p. 12.)

Net income for the period was \$1,297,575 before the return of \$368,843 to the U.S. Government on class A stock. The Bank is

## CHAPTER 1

### INTRODUCTION

The Rural Telephone Bank was established as a corporate body and an agency and instrumentality of the United States by Public Law 92-12, approved May 7, 1971, to meet the growing capital needs of rural telephone systems. The law amended the Rural Electrification Act of 1936 (7 U.S.C. 901) under which the Rural Electrification Administration (REA), Department of Agriculture, has been authorized, since October 1949, to make loans for furnishing and improving rural telephone service.

The general purposes of the Bank are to:

- Obtain an adequate supply of funds, from non-Federal sources to the extent feasible, to supplement REA's telephone loan program.
- Use its funds to make loans to providers of telephone service in rural areas which have received REA loans or loan commitments or which have been certified by the Administrator to be eligible for them.
- Conduct its operations, to the extent practicable, on a self-sustaining basis. The Congress objective was that the Bank eventually become an entirely privately owned, operated, and financed corporation.

To enhance the Bank's ability to obtain funds at the lowest possible cost, Public Law 92-324, approved June 30, 1972, further amended the Rural Electrification Act of 1936 to permit the Bank to issue debentures to the Secretary of the Treasury and to authorize him to purchase these debentures.

The act was further amended on May 11, 1973, by Public Law 93-32. The law amended title III of the act by establishing the Rural Electrification and Telephone Revolving Fund as a source for financing REA loans. The fund is to insure that adequate funds are made available to rural electric and telephone systems through direct, insured, and guaranteed loans. Public Law 93-32 also made the Bank's debentures obligations of the United States, established the interest

## CHAPTER 2

### FINANCING

#### CAPITALIZATION

The Bank's capital consists of capital stock subscribed by the U.S. Government, by borrowers from the Bank, by corporations and public bodies eligible to become borrowers from the Bank, and by organizations controlled by such entities. There are three classes of capital stock of the Bank.

Class A stock is issuable, at a par value of \$1 a share, only to the Administrator of REA on behalf of the United States. The act authorizes appropriations, not to exceed \$30 million annually, to purchase class A stock until this stock equals \$300 million. On August 10, 1972, the Congress appropriated \$30 million for the purchase of class A stock. The cumulative appropriations as of June 30, 1973, were \$60 million.

The act provides that class A stock be redeemed and retired by the Bank as soon as practicable after June 30, 1985, and after the amount of class A and class B stock issued totals \$400 million. However, the retirement of this stock, as determined by the Telephone Bank Board, must not impair the operations of the Bank. The minimum amount of class A stock that shall be retired shall equal the amount of class B stock sold by the Bank during the year.

Class A stock actually paid into the Bank by the Treasury is entitled to a return, payable from income, of 2 percent a year. The return is cumulative and is payable annually into miscellaneous receipts of the Treasury. In fiscal year 1973 the Bank paid the Treasury a return of \$368,843.

Class B stock is issuable, at a par value of \$1 a share, only to the Bank's borrowers. The borrowers are required by the act to invest in class B stock an amount equal to 5 percent of the amount of loans obtained from the Bank for purposes other than the purchase of class B stock. No dividends are payable on class B stock, but its holders are entitled to patronage refunds in class B stock from net income after provisions are made for a contingency reserve, the

conditions as to yield a return at a rate not less than a rate determined by him, taking into consideration the current average yield on outstanding marketable U.S. obligations of comparable maturity. The Bank did not issue any telephone debentures during fiscal year 1973.

#### LENDING POWER

The Bank is authorized by section 408(a) of the act to make loans, in conformance with policies approved by the Telephone Bank Board, to corporations and public bodies which have received telephone loans or loan commitments from REA under section 201 of the act or which have been certified by the Administrator to be eligible for such loans or loan commitments.

The Bank's loans may be made:

1. For the same purposes and under the same limitations as loans made by REA under section 201 of the act. Section 201 authorizes the Administrator, REA, to make loans to finance the improvement, expansion, construction, acquisition, and operation of telephone lines, facilities, or systems to furnish and improve telephone service in rural areas. Section 201 provides further that preference be given to persons (natural persons, firms, corporations, or associations) and public bodies providing telephone service in rural areas and to cooperative, nonprofit, limited-dividend, or mutual associations.

Insofar as possible, assurance must be obtained that the telephone service to be furnished or improved by a loan will be made available to the widest practicable number of rural users. A loan may be made to refinance the outstanding indebtedness of a person furnishing telephone service in rural areas, provided that such refinancing does not constitute more than 40 percent of the loan.

2. To finance or refinance the construction, improvement, expansion, acquisition, and operation of telephone lines, facilities, or systems to improve the efficiency, effectiveness, or financial stability of REA's or the Bank's telephone loan borrowers. The acquisition of existing telephone lines, facilities, or systems must be approved by the Secretary of Agriculture and must meet other specified conditions.

A loan made by the Bank under Public Law 92-12 was required to bear interest at the highest practicable rate consistent with the borrower's ability to pay but not less than 4 percent a year. Under the act the interest rates ranged from 4 to 8 percent a year.

Public Law 93-32 amended this loan provision by providing that the Bank's loans bear interest at the cost-of-money rate. This rate is the average cost of money to the Bank as determined by the Governor and may not be less than 5 percent a year. As a result of this amendment, a cost-of-money rate was established for all loans and the range in interest rates based on the borrowers' ability to pay was abolished. There is no provision for changing the interest rate for a loan after it has been made. Once the rate has been established for a loan, it will remain unchanged for the term of that loan--up to 35 years, depending on the loan's maturity date--even though the cost of money may undergo substantial fluctuations during that period. Section 305 of the law changed the annual interest rate for a telephone loan made by REA from 2 percent to 5 percent. However, it also authorized REA to make telephone loans to telephone borrowers meeting certain specified conditions at a special annual rate of 2 percent.

CONVERSION OF OWNERSHIP, OPERATION, AND  
CONTROL OF THE BANK

Whenever 51 percent of the maximum amount of class A stock issued to the United States and outstanding any time after June 30, 1985, has been fully redeemed and retired:

- The Governor of the Bank shall be selected by the Telephone Bank Board.
- The five members of the Board designated by the President shall cease to be members.
- The Bank shall cease to be an agency of the United States but shall continue in existence, in perpetuity, as an instrumentality of the United States and as a banking corporation.

When all class A stock has been fully redeemed and retired, loans made by the Bank shall no longer be subject

CHAPTER 3

OPERATIONS

EXPANSION OF OPERATIONS

Fiscal year 1973 was the first complete year of operation for the Bank after its creation by Public Law 92-12 on May 7, 1971. During 1973 the loan volume expanded considerably over the initial 9-month period of operation, October 1, 1971, to June 30, 1972. The number of telephone borrowers increased by 125, the amount of loan commitments increased by \$149,958,690, and the advances on loan commitments increased \$45,054,336. The total loan advances of \$45,642,259 made on loan commitments of \$240,913,490 were made to 93 borrowers, an increase of 91 borrowers.

	From inception through <u>June 30, 1973</u>	Fiscal year 1972 <u>(9 months)</u>	Fiscal year 1973 <u>(12 months)</u>
Loan commitments	\$240,913,490	\$90,954,800	\$149,958,690
Advances on loan commitments	45,642,259	587,923	45,054,336
Number of borrowers receiving:			
Loan commitments	214	89	125
Advances on loan commitments	93	2	91

The loan commitments of \$240,913,490 at June 30, 1973, included commitments of \$43,687,690 and \$197,225,800 to 37 cooperatives and 177 commercial companies, respectively, at interest rates ranging from 4 to 8 percent. The following chart shows the distribution of these borrowers and loan commitments by the interest rates.

## Net income and returns on capital stock

The Bank's net income for the period was \$1,297,575. The 2-percent return on class A stock payable to the Treasury from net income was \$368,843. At its August 10, 1972, meeting, the Telephone Bank Board established a reserve for contingencies in accordance with the Bank's bylaws and put the patronage capital (retained earnings) of \$3,311 for fiscal year 1972 in this reserve. The Board did not declare any patronage refunds on class B stock or dividends on class C stock in fiscal year 1973.

On July 26, 1973, after the close of fiscal year 1973, the Board declared a 4-percent dividend to class C stockholders of record on June 30, 1973, and a patronage refund to class B stockholders equal to 10 percent of the interest revenue from these stockholders. The patronage refund is payable in additional class B stock to the holders of this stock. The class C stockholders received \$21,000 in cash dividends, and the class B stockholders received patronage refunds of \$114,517 in additional shares of class B stock. The dividends and patronage refunds were charged against net income of \$928,732, computed by deducting the operating expenses and the provision for the return on class A stock from the total income for the period. The remaining net income balance of \$793,215 was put in the reserve for contingencies by direction of the Board.

## SOURCE OF FUNDS

The act authorizes the Bank to obtain funds through the public or private sale of telephone debentures. The Bank had not used this method of financing from its inception to June 30, 1973. However, on July 26, 1973, the Bank issued a debenture in the form of a note to the Secretary of the Treasury to fund advances, as needed, on Bank loans. The Bank's Board of Directors approves issuance of the note.

## ALLOWANCE FOR POSSIBLE LOSSES ON LOANS AND INTEREST RECEIVABLE

During the year the Bank increased the allowance for possible losses on loans and interest receivable to \$6,200, in accordance with a policy the Board of Directors adopted. This policy authorized using a method of computation provided

## CHAPTER 4

### SCOPE OF EXAMINATION

Our audit of the Rural Telephone Bank consisted principally of an examination of its statement of financial condition at June 30, 1973, the related statements of income and patronage capital (retained earnings), and the changes in financial position for the year ended June 30, 1973. We reviewed the system of internal control and the basic laws, rules, and regulations applicable to the Bank, to ascertain the policies and restrictions under which it was required to operate. We made our audit at the Rural Telephone Bank, Washington, D.C.

We made our audit in accordance with generally accepted auditing standards and included such tests of the Bank's accounting records and financial transactions and such other auditing procedures as we considered necessary in the circumstances.

SCHEDULE 1

RURAL TELEPHONE BANK

BALANCE SHEET

JUNE 30, 1973

ASSETS

CASH:		
With U.S. Treasury (note 1)		\$14,545,385.98
On hand		1,277,65
INVESTMENTS:		
In U.S. Government securities at amortized cost (note 2)	<sup>a</sup> \$ 6,894,829.19	
Accrued interest on securities	<u>125,452.20</u>	7,020,281.39
LOANS RECEIVABLE (note 3):		
Loans receivable	45,629,102.08	
Accrued interest on loans	<u>234,718.27</u>	
	45,863,820.35	
Less: Allowance for possible losses	<u>6,200.00</u>	45,857,620.35
UNAMORTIZED PREOPERATING COSTS		<u>4,813.72</u>
		<u>\$67,429,379.09</u>

LIABILITIES AND EQUITIES

LIABILITIES:		
Accounts payable and accrued liabilities	\$ 3,298.00	
Return payable to the U.S. Treasury on Class A stock (note 4)	<u>368,842.98</u>	\$ 372,140.98
EQUITY OF THE UNITED STATES GOVERNMENT:		
Class A stock		60,000,000.00
EQUITY OF THE PUBLIC:		
Class B stock:		
Total subscriptions	11,472,945.00	
Less: unissued	<u>5,872,750.00</u>	
Issued	5,600,195.00	
Class C stock	<u>525,000.00</u>	6,125,195.00
PATRONAGE CAPITAL:		
Reserve for contingency (note 6)	3,311.25	
Net income after provision for return on Class A stock--12 months ended June 30, 1973	<u>928,731.86</u>	<u>932,043.11</u>
		<u>\$67,429,379.09</u>

GAO note:

<sup>a</sup>The market value of the securities at June 30, 1973, was \$6,762,169. The Bank intends to hold these securities to maturity.

The notes and summary of significant accounting policies following schedule 3 are an integral part of this statement.

## RURAL TELEPHONE BANK

## STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED JUNE 30, 1973

## RESOURCES WERE PROVIDED BY:

Investment in class A stock by the U.S. Government	\$30,000,000.00
Investment in class B stock by borrowers	5,467,645.00
Investment in class C stock by borrowers and others	65,000.00
Interest earned on loans and investments in U.S. Government securities	1,337,372.01
Decrease in preoperating costs by amortization and adjustment	6,514.60
Increase in accounts payable and other liabilities	369,565.60
Decrease in cash	14,919,033.58
Principal collected on loans	<u>13,156.92</u>
	<u>\$52,178,287.71</u>

## RESOURCES WERE USED FOR:

Investments in U.S. Government securities	\$ 6,370,098.41
Advances on loan commitments to borrowers (net of provision for possible losses, \$6,000)	45,048,336.00
Increase in interest on loans and investments in U.S. Government securities	351,213.15
Return to U.S. Government on class A stock investment	368,842.98
Current period's operating expenses	<u>39,797.17</u>
	<u>\$52,178,287.71</u>

The notes and summary of significant accounting policies following schedule 3 are an integral part of this statement.

6. Patronage capital of \$3,311.25, representing the retained earnings at June 30, 1972, has been placed in a contingency reserve by the Board on August 10, 1972, in accordance with provisions of Section 8.2, Article VIII, of the Bank's bylaws.

## RURAL TELEPHONE BANK

## BOARD OF DIRECTORS

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
EX OFFICIO MEMBERS:		
David A. Hamil, Administrator, REA	May 1971	Present
E.A. Jaenke, Governor, Farm Credit Administration	May 1971	Present
MEMBERS REPRESENTING THE DEPARTMENT OF AGRICULTURE:		
Carroll G. Brunthaver, Assistant Secretary of Agriculture	June 1972	Jan. 1974
Dr. Thomas K. Cowden, Assistant Secretary of Agriculture	Sept. 1971	Feb. 1973
William W. Erwin, Assistant Secretary of Agriculture	July 1973	Present
Dr. Eric Thor, Administrator, Farmer Cooperative Service	Sept. 1971	Aug. 1973
MEMBERS REPRESENTING THE PUBLIC:		
Mrs. Paula F. Hawkins, Commissioner, Florida Public Service Commission	July 1973	Present
Charles H. Pillard, President, International Brotherhood of Electrical Workers	Sept. 1971	Present
Willis F. Ward, Chairman, Michigan Public Service Commission	Sept. 1971	Feb. 1973
MEMBERS REPRESENTING COOPERATIVE- TYPE ENTITIES:		
Glen W. Bergland, manager, Winnebago Cooperative Telephone Association, Thompson, Iowa	Sept. 1971	Present

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